



B-04/01  
January 5, 2004

## **Congress Passes Bill Affecting State Taxation of Military Personnel**

### **Summary**

Congress has passed H.R. 100, the Servicemembers Civil Relief Act, and it was signed into law on Dec. 19 as Public Law No. 108-189. This is an update and expansion of what has been known as the Soldiers' and Sailors' Civil Relief Act of 1940. The new law prohibits use of "the California method," a method of determining the income tax rate to be applied against taxable income, when taxing servicemembers. It also contains some lesser limitations and procedural requirements relating to the collection of delinquent taxes and seizure of property.

Congress has passed H.R. 100, the Servicemembers Civil Relief Act, and it was signed into law on Dec. 19 as Public Law No. 108-189. This is an update and expansion of what has been known as the Soldiers' and Sailors' Civil Relief Act of 1940. The enrolled version of H.R. 100 is available at <http://thomas.loc.gov>.

The bill includes a preemption of state taxing authority that may complicate the upcoming income tax filing season for the 2003 tax year individual income tax returns. Attorneys should also note that the preemption appears to have the potential to affect any open cases under appeal or dispute. This bulletin will discuss this preemption before summarizing the remainder of the bill.

### **"California method"**

The new law prohibits a procedure used in approximately 19 states with graduated income tax rates. The procedure, known commonly as "the California method,"<sup>1</sup> considers a servicemember's total household income when determining the tax rate to be applied against the portion of household income that may be taxed by that state. The California method calculates the taxable income of a nonresident taxpayer, whether military or civilian, as if the taxpayer were a fulltime resident. The total tax is then apportioned by the proportion of income that the state may lawfully tax. The method was put in place to apply graduated tax rates in the same manner to all taxpayers. The other approach used in the remaining states is to apportion the income as

---

<sup>1</sup> While it is called the 'California method,' the policy was actually originally litigated on its constitutional merits by Vermont and Kansas. *Wheeler v. Vermont* Vt. S. Ct. 253 A.2d 887 (1969) Appeal dismissed per curiam 396 U.S. 4 (1969) and *U.S.A. v. Kansas* 810 F. 2d 935 (10th Cir. 1987).

to resident and nonresident before determining the tax due.

Detractors of the method argued that it had the perceived effect of taxing income earned outside the state.

The pertinent language reads as follows:

**SEC. 511. RESIDENCE FOR TAX PURPOSES.**

(d) INCREASE OF TAX LIABILITY.—A tax jurisdiction may not use the military compensation of a nonresident servicemember to increase the tax liability imposed on other income earned by the nonresident servicemember or spouse subject to tax by the jurisdiction.

The effective date given in the bill reads as follows (emphasis added):

**SEC. 3. EFFECTIVE DATE.**

The amendment made by section 1 shall apply **to any case that is not final** before the date of the enactment of this Act.

Your attorneys will want to make their own determinations about what this means for your state, but the effective date appears to have the potential to affect the 2003 income tax return.

**Other provisions in the bill**

The new law was designed in large part to update the Soldier and Sailors' Relief Act of 1940 by making it gender neutral, assuring it encompassed branches of the military that did not exist in 1940, and similar updates that can be considered technical in nature.

Substantive provisions of the bill include a broad range of protections for servicemembers from civil actions such as debt collection, eviction and contract enforcement, if the servicemember has been limited in fulfilling his or her obligations by duty requirements.

These protections do not by themselves forgive a debt or contractual obligation but they do extend deadlines, call for a court's determination, or allow default judgments to be challenged.

**Court order necessary for seizures**

One section of interest to state taxing authorities limits a state's ability to seize property due to unpaid debt. While there is an exemption for personal income tax, there are no exceptions for business taxes. The provision reads as follows:

“SEC. 501. TAXES RESPECTING PERSONAL PROPERTY, MONEY, CREDITS, AND REAL PROPERTY.

“(b) SALE OF PROPERTY.—

“(1) LIMITATION ON SALE OF PROPERTY TO ENFORCE TAX ASSESSMENT.—Property described in subsection (a) may not be sold to enforce the collection of such tax or assessment

except by court order and upon the determination by the court that military service does not materially affect the servicemember's ability to pay the unpaid tax or assessment.

### **Domicile, residence and Native American issues**

Also, we would bring your attention to the entire section 511, Residence for Tax Purposes. The section restates that residence and domicile for tax purposes do not change because of a servicemember's posting to another jurisdiction. Likewise, the new law affirms the existing law that prohibits a state from taxing the income of a servicemember whose domicile is in another state. A Native American who is domiciled on a reservation is taxed under federal laws that apply to reservations, not state laws. And finally, subsection (4) requires personal property tax relief be granted whether or not the servicemember does not pay the tax to his or her state of domicile.

“SEC. 511. RESIDENCE FOR TAX PURPOSES.

“(a) RESIDENCE OR DOMICILE.—A servicemember shall neither lose nor acquire a residence or domicile for purposes of taxation with respect to the person, personal property, or income of the servicemember by reason of being absent or present in any tax jurisdiction of the United States solely in compliance with military orders.

“(b) MILITARY SERVICE COMPENSATION.—Compensation of a servicemember for military service shall not be deemed to be income for services performed or from sources within a tax jurisdiction of the United States if the servicemember is not a resident or domiciliary of the jurisdiction in which the servicemember is serving in compliance with military orders.

“(c) PERSONAL PROPERTY.—

“(1) RELIEF FROM PERSONAL PROPERTY TAXES.—The personal property of a servicemember shall not be deemed to be located or present in, or to have a situs for taxation in, the tax jurisdiction in which the servicemember is serving in compliance with military orders.

“(2) EXCEPTION FOR PROPERTY WITHIN MEMBER'S DOMICILE OR RESIDENCE.—This subsection applies to personal property or its use within any tax jurisdiction other than the servicemember's domicile or residence.

H. R. 100—25

“(3) EXCEPTION FOR PROPERTY USED IN TRADE OR BUSINESS.

—This section does not prevent taxation by a tax jurisdiction with respect to personal property used in or arising from a trade or business, if it has jurisdiction.

“(4) RELATIONSHIP TO LAW OF STATE OF DOMICILE.—Eligibility for relief from personal property taxes under this subsection is not contingent on whether or not such taxes are paid to the State of domicile.

“(d) INCREASE OF TAX LIABILITY.—A tax jurisdiction may not use the military compensation of a nonresident servicemember to increase the tax liability imposed on other income earned by the

nonresident servicemember or spouse subject to tax by the jurisdiction.

“(e) FEDERAL INDIAN RESERVATIONS.—An Indian servicemember whose legal residence or domicile is a Federal Indian reservation shall be taxed by the laws applicable to Federal Indian reservations and not the State where the reservation is located.

“(f) DEFINITIONS.—For purposes of this section:

“(1) PERSONAL PROPERTY.—The term ‘personal property’ means intangible and tangible property (including motor vehicles).

“(2) TAXATION.—The term ‘taxation’ includes licenses, fees, or excises imposed with respect to motor vehicles and their use, if the license, fee, or excise is paid by the servicemember in the servicemember’s State of domicile or residence.

“(3) TAX JURISDICTION.—The term ‘tax jurisdiction’ means a State or a political subdivision of a State.

We hope you find this information helpful. Please refer your questions to Verenda Smith at 202-624-8443 or [verenda.smith@taxadmin.org](mailto:verenda.smith@taxadmin.org).

Sincerely,

Harley T. Duncan  
Executive Director